EXECUTIVE SUMMARY

1 Background

Indian Railways (IR) is a prime mover in the transport sector of the nation. It is one of the largest railway systems in the world under a single management and is the single largest mover of freight in the country. Despite improvement in growth rate of freight, the market share of IR in freight transport has declined substantially from 53 to about 35 *per cent* in the last two decades. Creation of adequate capacity network was, therefore, essential to meet the challenges in growth of freight traffic.

The critical input identified by IR was the significant investment required for execution of projects to enhance capacity of railway's network. Shortfall in internal generation of resources coupled with inadequate budgetary support led IR to heavily rely on private sector investments. Public Private Partnership mode (PPP), Joint Venture Model, BOT[1] model were some of the policies through which IR sought private investment.

IR executed eight PPP projects consisting of five Gauge Conversion and three New Line projects since 2000 through Special Purpose Vehicles (SPVs) and one Special Purpose Company (SPC) in collaboration with private partners. Audit study includes a sample of four Gauge Conversion projects such as PRCL, VMPL, HMRDC and Kutch Railway Company Ltd and two ongoing New Line projects namely HPRCL and KRCL

2 Highlights of the Report

This Performance Audit Report highlights the procedure adopted for selection of private partners, clarity, transparency and completeness of contractual documents such as Shareholders Agreement, Concession Agreement and Traffic Guarantee Agreement etc. executed with SPVs including financial prudence of IR while processing each project.

Audit observed that all PPP projects undertaken by the MoR were considered economically viable except HMRDC and KRCL where the IRR was less than the benchmark prescribed by the MoF. Assessment of IRR was not realistic in all the cases. Projects with high IRR (PRCL) witnessed loss due to shortfall against the

---

[1] Built, Operate and Transfer- Applicable for sanctioned projects where it is not possible to identify stakeholders. The projects are awarded on design, build, finance, maintain and transfer.

projected traffic. Earning of Railway from the VMPL project was about 60 *per cent* less than annual cash outflow though IRR was estimated as 22 *per cent.*

IR did not formulate any Model Concession Agreement nor did it prefer to follow the one prescribed by the Planning Commission for PPP projects in infrastructure sector.

Grant of concession period to concessionaires was arbitrary ranging from 12 years to 32 years. Adequate justification was not available on record for levying a nominal lease rent. Overhead charges were deferred without linking it to the IRR and actual profitability of projects. Concerns regarding inadequacy of contractual provisions as expressed by authorities at the field levels in case of Kutch Railway Company Limited were not addressed by the competent authorities at the Railway Board level. Due to weak monitoring of the progress of the projects, adequate remedial measures were not initiated at the project implementation stage in case of HPRCL and KRCL.

This report comprises of five chapters including introduction, audit objectives, scope of audit, methodology etc. as detailed in Chapter 1. Chapter 2 of the report highlights the deficiencies in selection of equity partners including completeness of the Shareholders Agreement after the formation of SPV/SPC. While Chapter 3 deals with the review of the terms and conditions incorporated in different agreements, issues such as recovery of Operation and Maintenance cost of the projects, Traffic Guarantee Agreement with SPVs, effective monitoring of the projects has been discussed in Chapter 4. Chapter 5 highlights the overall conclusion of the Performance Audit along with recommendations.

2.1 Major Audit Findings

2.1.1 Selection of Private Partners

i. All the projects were considered economically viable except HMRDC and KRCL where the IRR[2] was estimated as 10.5 and 11.8 *per cent* respectively as against the minimum benchmark of 14 *per cent* prescribed by the MoF.

(Para 2.1)

ii. The Shareholder Agreement was incomplete in case of PRCL at the initial stage itself as three new partners were included subsequent to signing of the Agreement. **(Para 2.3.1)**

[2] Internal Rate of Return (IRR) of a project is the annualized effective compounded rate that makes the Net Present Value of all cash flows (both positive and negative) from a particular investment equal to zero.

iii. Approval of MoF was not obtained for taking up VMPL project through BOT mode on payment of access charges. Annual earning of the project was ₹ 6.45 crore against the annual access charge payment of ₹15.94 crore. The project sustained loss despite estimated IRR of 22 *per cent*.

(Para 2.3.2)

iv. In HMRDC, the shareholders Agreement included ₹141 crore as subordinate debt of MoR recoverable from HMRDC. In absence of a provision in the agreement for repayment of debt and interest liability thereon, 56 *per cent* of this debt is yet to be repaid by HMRDC (March 2013).

(Para 2.3.3)

v. Kutch Railway Company Limited was a profitable project with IRR estimated as 17.81 *per cent.* Traffic Guarantee Agreement was, however, not executed as the equity partners did not agree to execute the same.

(Para 2.3.4)

vi. RVNL was mandated to implement the projects on fast track basis on behalf of IR. In case of HPRCL, there was a delay of 15 months in formation of SPV from the date of signing of the MoU. Inordinate delay of 53 months was also observed in case of KRCL between selection of partners and approval of project by the MoR. **(Para 2.4.1 and 2.4.2)**

2.1.2 Concession Agreements

i. MoR did not formulate any Model Concession Agreement for PPP projects. On the contrary, MoR finalized each agreement separately based on its experience in PRCL, the first PPP project and the same was adopted as benchmark while finalising subsequent Concession Agreements with HMRDC and Kutch Railway Company. **[Para 3.1 (i)]**

ii. There was significant delay in signing of the Concession Agreement. The time gap between formation of SPV and subsequent signing of concession agreement was in the range of 270 to 540 days. **[Para 3.1 (ii)]**

iii. Concession period was not linked with the IRR of the projects. The Concession Period adopted was in the range of 12 to 33 years. The reasons for adoption of different concession period were not available on record. Further, the date of commencement of concession period was not mentioned in the Concession Agreement in case of HPRCL and KRCL.

[(Para 3.1 (iii and iv)]

iv. Concession Agreement with Kutch Railway Company Limited lacked provisions for review and modification of the terms and conditions of the agreement to safeguard against unforeseen eventualities to protect the financial interest of the IR.

(Para 3.1 1)

2.1.3 Lease Rent

i. Despite being pointed out by the Western Railway, the correctness of the valuation of the assets leased to PRCL was not confirmed by the MoR. This resulted in short recovery of lease rent amounting to ₹ 3.60 crore per annum since June 2001 due to erroneous adoption of cost of the assets as ` 44.18 crore instead of ₹ 44.18 crore. **(Para 3.2.1.1)**

ii. Lease Agreement was incomplete as the area of land leased to the SPVs was not mentioned in all the agreements. SPVs (VMPL, HMRDC and Kutch Railway Company Ltd) were permitted to commercially exploit the land leased to them at a nominal rent and the reasons thereof were not available on record. **(Para 3.2.1.2)**

iii. While executing the Lease Agreement with Kutch Rail Company Limited, the extant Railway Board's instructions (February 2005) of recovery of lease rent at the rate of 6 *per* cent of the market value of the land was not followed. This resulted in loss of ₹ 4 crores per annum since November 2005.

[Para 3.2.1.2 (iv)]

iv. The Lease Agreement with HPRCL provided for the recovery of lease rent as per extant instructions of Railway Board in this regard. An amount of ₹2.34 crore due as lease rent was not recovered from HPRCL for the period December 2007 to March 2013.

(Para 3.2.2.1)

2.1.4 Transfer of Assets

Uniform policy was not adopted for payments to be made by IR to the SPVs at the time of transfer of the project assets on completion of the Concession Period. While the amount of transfer payment in case of PRCL and HMRDC was equal to Depreciated Replacement Value of the assets, the transfer amount was equal to the book value of the assets in case of Kutch Rail Company Limited, HPRCL and KRCL. **(Para 3.3)**

2.1.5 Financial Close

Financial Close implies fulfillment of all the conditions precedent to availability of the funds for the concerned PPP projects. This was not achieved in case of HPRCL and KRCL even after six years of signing the Concession Agreements. The project cost in case of HPRCL and KRCL escalated by about 100 *per cent.* The revised project cost is yet to be approved by the SPV Board. **(Para 3.4)**

2.1.6 Project Execution

i. Kutch Railway Company Ltd recovered the entire cost of the project within six years of its operation. MoR approved doubling of the line to derive the additional benefit. Western Railway (General Manager), however, requested for termination of this agreement as continuation of the existing agreement would severely undermine the earnings of WR. MoR did not initiate any action as they considered it prudent to augment line capacity by utilizing funds provided by SPV in view of the resource crunch of IR.

(Para 4.1)

ii. The project cost in case of HPRCL and KRCL escalated by about 100 *per cent* due to delay in land acquisition, increase in the cost of construction of major bridges, permanent way material etc. A private line (DPCL) was constructed under identical circumstances, parallel to the proposed new line of HPRCL. Operation of this private line is likely to have an adverse impact on the earning of the HPRCL in the long run.

(Para 4.2.1 and 4.2.2)

2.1.7 Operation and Maintenance

Deferring of recovery of overhead charges was not linked to the earnings of the SPVs and the deferred charges were slated to be recovered after a period of 10 years in case of PRCL and Kutch Railway Company Ltd with IRR more than the prescribed benchmark of MoF.

CCEA note provided for deferring of recovery of overhead charges for five years in case of HMRDC. MoR, however, deferred recovery of overhead charges over a period of 10 years of operation. Reasons to justify deferring of recovery of overhead charge for 10 years instead of five years were not available on records. **(Para 4.3)**

2.1.8 Traffic Guarantee Agreement

Viability of a project is based on IRR of the project which, in turn, is assessed considering the freight earnings that the project is likely to fetch during the concession period. A minimum Traffic Guarantee Agreement is, therefore, essential to ensure that the project is viable and sufficient earnings are generated to cover the cost of project.

i. This crucial agreement was not executed in case of VMPL, Kutch Railway Company, HMRDC and KRCL;

ii. PRCL achieved the target for minimum guaranteed traffic during the eighth year of operation of the project. There was, however, no provision in the agreement for revision of the quantum of minimum guaranteed traffic once the targeted traffic volume is achieved by the SPV; and

iii. The penal provisions for shortfall in offering minimum guaranteed traffic in case of PRCL were complex to quantify in absolute financial terms. **(Para 4.4 and 4.4.1)**

2.1.9 Monitoring

Though monthly progress reports were being prepared by SPVs, there were, however, no records confirming the fact that the progress of the projects was being monitored by the Construction Progress Review Board. The role of MoR for monitoring the performance of projects were not laid down in any of the Concession Agreements. **(Para 4.5)**